INDEX

	Page
Petition:	
Question presented	1
Statutes and Regulation Involved	2
Statement	3
Specification of Errors to be urged	6
Reasons for granting the writ	6
Brief in support of petition:	
Opinions below	8
Jurisdiction	8
Statement	8
Argument:	
I. The determination of taxable gain in this case is governed by a special provision of the statute	8
II. Sec. 213 (b) (2) of the Revenue Act of 1918 is not unconstitutional as applied to life insurance, endowment, or annuity contracts issued prior to March 1, 1913	11
III. The fair market price or value of the respondent's deferred dividend policies on March 1, 1913, was not in excess of their then cash surrender value of $74,000	12
IV. The Departmental construction of the statute	14
Conclusion	16

CITATIONS

Cases:	
Armstrong, E. A., Appeal of, 1 B. T. A. 296	7, 14
Chamensky v. Commissioner, 8 B. T. A. 1276	7
Kline, Appeal of, 2 B. T. A. 1138	7
National Lead Co. v. United States, 252 U. S. 140	16
New York Life Insurance Co. v. Edwards, 271 U. S. 109	6, 12, 13
Penn Mutual Life Insurance Co. v. Lederer, 252 U. S. 523	6, 12, 13
Townsend v. Little, 109 U. S. 504	10
Statutes:	
Revenue Act of 1918, c. 463, sec. 6, 39 Stat. 756	14
Revenue Act of 1918, c. 18, 40 Stat. 1057—	
Sec. 202 (a)	2, 10
Sec. 213	2
Revenue Act of 1921, c. 136, Sec. 213 (b), 42 Stat. 237	14
Revenue Act of 1924, c. 234, Sec. 213, (b) 43 Stat. 253	14
Revenue Act of 1926, c. 27, Sec. 213 (b), 44 Stat. 9	14
Revenue Act of 1928, Act of May 29, 1928, Sec. 22 (b) (2)	15
Regulations:	
Treasury Department 33 (Revised), Art. 5	15
" " 45 (1930 Edition), Art. 72	8, 9
" " 62, Art. 72	15
" " 65, Art. 72	15

In the Supreme Court of the United States

OCTOBER TERM, 1928

No.———

ROBERT H. LUCAS, COLLECTOR OF INTERNAL REVENUE for the District of Kentucky, petitioner

v.

A. J. A. ALEXANDER

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF

PETITION

The Solicitor General, on behalf of Robert H. Lucas, former Collector of Internal Revenue for the District of Kentucky, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Sixth Circuit entered in the above case on June 30, 1928, affirming the judgment of the District Court of the United States for the Western District of Kentucky.

QUESTION PRESENTED

What taxable gain was realized by the taxpayer under the provisions of Sections 213 (b) (2) and 202 (a) (2) of the Revenue Act of 1918, *infra*, upon surrender by him, at maturity, May 19, 1919, of two

participating, deferred dividend policies issued to him on May 19, 1899?

STATUTES AND REGULATION INVOLVED

Revenue Act of 1918, c. 18, 40 Stat. 1057:

SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—

(a) Includes gains, profits, and income derived from * * * sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *.

(b) Does not include the following items, which shall be exempt from taxation under this title:

* * * * *

(2) The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract.

* * * * *

SEC. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be:

(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

(2) In the case of property acquired on or after that date, the cost thereof; * * *.

Regulations 45 (1920 Edition), Art. 72 (b):

> During his life only so much of the amount received by an insured under life, endowment or annuity contracts as represents a return, without interest, of premiums paid by him therefor is excluded from his gross income.

STATEMENT

Respondent on June 5, 1899, was issued, effective May 19, 1899, two policies of life insurance by the New York Life Insurance Company. (R. 16–30.) The face value of each policy was $50,000.00. (R. 16, 23.) Each was a participating deferred dividend policy called "Insurance bond with guaranteed interest." (R. 16, 23.) The accumulation period of each was twenty years. (R. 17, 24.) The policies were fully paid up on March 19, 1908, after ten premium payments aggregating $78,100 had been paid. (R. 53.)

The policies provided for certain payments in the event of the death of the insured during the accumulation period (R. 21, 28); and for certain accumulation guarantees and benefits if the insured lived to the end of the accumulation period (R. 22, 29–30). Each policy contained the following provisions:

> This Insurance Bond participates in surplus as hereinafter provided, *but no dividend shall be apportioned to it before the end of the Accumulation Period.* (R. 53.)
>
> * * * * *
>
> The Accumulation Period of this Insurance Bond ends on the nineteenth day of May in the year nineteen hundred and nineteen. If

> the insured is living; and if the premiums have been duly paid to that date, and not otherwise, THE COMPANY WILL THEN APPORTION A DIVIDEND TO THE INSURED * * *. (R. 54.)
>
> * * * * *
>
> The Company guarantees that the entire cash value of this Insurance Bond at the end of the Accumulation Period shall be Fifty thousand Dollars, and in addition the cash dividend *then apportioned by the Company*. (R. 54.) (Italics supplied.)

The taxpayer being alive at the maturity of the policies on May 19, 1919, he elected to receive the cash surrender value of the policies, and, on surrendering the policies, was paid by the insurance company the sum of $120,797. (R. 55.) The aggregate dividends then apportioned amounted to $20,797 for the two policies. (R. 22, 30.)

He returned for taxation as income $17,290.35, claiming that the remaining $103,506.65 represented the March 1, 1913, value of his policies. (R. 11.)

The Commissioner of Internal Revenue found that the taxable gain was $42,697, the difference between the sum received, $120,797, and the total of premiums paid, $78,100, without interest. (R. 55.) A deficiency tax of $11,334.17 was assessed, of which respondent paid, under protest, $8,750.91 (R. 55), and thereafter brought suit in the District Court of the United States for the Western District of Kentucky for its recovery (R. 1, 44).

The loan value of each of the policies on March 1, 1913, was $37,300 (R. 21, 29), a total of $74,600.

This loan value was the equivalent of a cash surrender value. (R. 68.) The record of the insurance company shows that on March 1, 1913, the share of each of these policies in "the aggregate sum provisionally ascertained and held awaiting apportionment" was $6,800 (R. 68), a total of $13,600.

The District Court determined the March 1, 1913, value of these policies as follows:

The policies being fully paid up, the insurance company had provisionally set aside certain sums as the accumulation on these policies which, on March 1, 1913, amounted to $13,600. Assuming that the same rate of accumulation would continue, it appeared at that time that this amount would grow by May 19, 1919, to the sum of $19,428.57, which, added to the face value of the policies, would make a total estimated value of $119,428.27. The present value of this sum on March 1, 1913, at 4 per cent per annum compounded annually was found to be $93,587.81, and this sum deducted from the amount actually received, $120,797, gave $27,209.19 as the taxable gain. (R. 42–43.) Judgment was rendered for the plaintiff on this basis. (R. 44.)

The Circuit Court of Appeals for the Sixth Circuit, on writ of error, affirmed the judgment of the court below, and sustained the method adopted by the lower court in determining the March 1, 1913, market price or value of said policies as $93,587.81. (R. 93.) It held that Article 72 (b) of Treasury Regulations 45 (1920 Edition) is "contrary to law in so far as it attempts to regulate income tax on

proceeds of insurance policies having a fair market price or value on March 1, 1913." (R. 96.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred in holding that the taxable gain realized by the taxpayer, upon surrender by him at maturity of the two insurance policies involved in this case, was only $27,209.19; and in failing to hold, under the provisions of Sections 213 (b) (2) and 202 (a) (2), Revenue Act of 1918, *supra*, that the taxable gain realized by the taxpayer was the difference between the sum paid him by the insurance company, $120,797, and the total of premiums paid, $78,100, without interest, or $42,697.

REASONS FOR GRANTING THE WRIT

1. The Circuit Court of Appeals has decided in this case an important question of Federal taxation, which has not been, but should be, settled by this Court.

2. The Circuit Court did not apply or construe an applicable provision of the statute, which would seem to be controlling in cases of this nature, Sec. 213 (b) (2), Revenue Act of 1918, c. 18, 40 Stat. 1057, 1065.

3. The decision of the Circuit Court of Appeals is not in harmony with important principles announced by this Court in analogous cases—*Penn Mutual Life Insurance Co.* v. *Lederer*, 252 U. S. 523, 529; *New York Life Insurance Co.* v. *Edwards*, 271 U. S. 109.

4. The decision of the Circuit Court of Appeals is contrary to the rulings of the United States Board of Tax Appeals—*Appeal of E. A. Armstrong*, 1 B. T. A., 296; *Appeal of Kline*, 3 B. T. A. 1138; *Chamansky* v. *Commissioner*, 8 B. T. A. 1276; and also opposed to the long-continued departmental construction of the statute.

5. The case is one of great public interest and of great importance to the Government in the administration of the revenue laws, since the decision of said Circuit Court of Appeals affects the taxability of the proceeds of every life insurance policy, annuity, or endowment contract issued prior to March 1, 1913, and paid to the insured during his lifetime. In order that the revenue laws may be properly administered by the Treasury Department, an authoritative decision by this Court is necessary.

WHEREFORE, it is respectfully submitted that this petition for writ of certiorari to review the judgment of the Circuit Court of Appeals for the Sixth Circuit should be granted.

WILLIAM D. MITCHELL,
Solicitor General.

SEPTEMBER, 1928.

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BRIEF IN SUPPORT OF PETITION

OPINIONS BELOW

The opinion of the District Court of the United States for the Western District of Kentucky (R. 37–44) is reported in 21 F. (2d) 68. The opinion of the Circuit Court of Appeals for the Sixth Circuit (R. 93) is not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals for the Sixth Circuit was entered on June 30, 1928. (R. 93.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

STATEMENT

A statement of the facts and of the errors relied on will be found in the petition.

ARGUMENT

I

THE DETERMINATION OF TAXABLE GAIN IN THIS CASE IS GOVERNED BY A SPECIAL PROVISION OF THE STATUTE

After providing by Section 213 (a) of the Revenue Act of 1918, 40 Stat. 1057, 1065, for the inclusion in gross income of "gains or profits and income derived from any source whatever," and that "the amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer," Congress, in subsection (b) (2) of said Section 213, enacted a special provision for the determination of taxable gain or net income derived by the insured

from any life insurance, endowment, or annuity contract during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract. It was there provided that gross income did not include, and that there should be exempt from taxation,

> The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract.

In thus providing for the noninclusion in gross income of the amount received by the insured as a return of premiums, Congress was evidently proceeding on the theory that such premiums represented the cost of the insurance contract. It clearly intended that amounts received by the insured in excess of premiums paid should be included in gross income and taxed in the year in which received.

Article 72 (b) of Regulations 45 (1920 Edition), duly promulgated by the Treasury Department under said Revenue Act of 1918, provides:

> During his life only so much of the amount received by an insured under life, endowment or annuity contracts as represents a return, without interest, of premiums paid by him therefor is excluded from his gross income.

The Commissioner of Internal Revenue based his determination of respondent's net income for the year 1919, in so far as it was derived from these insurance

policies, upon said Section 213 (b) (2) and said Article 72 (b) of said Regulations 45.

The Circuit Court of Appeals held (R. 96):

> • • • the regulation is contrary to law in so far as it attempts to regulate income tax on proceeds of insurance policies having a fair market price or value on March 1, 1913.

This can only mean that, in the opinion of the Circuit Court of Appeals, the regulation is contrary to the provisions of Section 202 (a) (1) of the Revenue Act of 1918, c. 18, 40 Stat. 1057, 1060. Clearly the regulation is not contrary to Section 213 (b) (2) of the said Act, for it is in practically the same language. If the regulation is contrary to law and void, then it would seem to follow that said Section 213 (b) (2), in so far as it applies to insurance policies issued prior to March 1, 1913, is unconstitutional and void. Otherwise it must be accepted as controlling; for Section 202 (a) (1) and (2) of the said Revenue Act of 1918 are general provisions relating to the computation of taxable gain from the sale or other disposition of property, and Section 213 (b) (2) is a specific provision relating to the same subject matter when the gain is derived from the disposition of life insurance, endowment, or annuity contracts.

It is a well-recognized rule of statutory construction that when there is a general and a specific provision of a statute relating to the same matter the specific provision will be construed as "qualifying and supplying exceptions to the general." *Townsend* v. *Little*, 109 U. S. 504, 512.

Construed as an exception to the general provisions of said Section 202 (a) (1), the Circuit Court of Appeals and the District Court should have accepted said Section 213 (b) (2) and the regulations adopted pursuant thereto as controlling, and as the basis for determining the taxable gain from the policies here in question.

II

SEC. 213 (B) (2) OF THE REVENUE ACT OF 1918 IS NOT UNCONSTITUTIONAL AS APPLIED TO LIFE INSURANCE, ENDOWMENT, OR ANNUITY CONTRACTS ISSUED PRIOR TO MARCH 1, 1913

In providing that of the sum received by an insured during his lifetime on life insurance, endowment, or annuity contracts, only the amount or amounts paid as premiums should be exempt from taxation as income, Congress was not exceeding its authority, notwithstanding the fact that the contract may have been issued prior to March 1, 1913. This allowance is favorable to the taxpayer, for, as illustrated by this case, it creates an exemption greater than the cash surrender value of the policy. On March 1, 1913, the cash surrender value of the two policies in question was only $74,600, whereas the total of the premiums paid was then $78,100. (R. 21, 29, 55.)

In so limiting the sum exempt from taxation Congress was merely excluding speculative values depending on various contingencies, such as the solvency or continued solvency of the company issuing the contracts, its earning capacity, the keeping up of premium payments, the probability that the insured

would live to the end of the accumulation period, etc. This it could properly do. *Penn Mutual Life Insurance Co.* v. *Lederer*, 252 U. S. 523; *New York Life Insurance Co.* v. *Edwards*, 271 U. S. 109.

III

THE FAIR MARKET PRICE OR VALUE OF THE RESPONDENT'S DEFERRED DIVIDEND POLICIES ON MARCH 1, 1913, WAS NOT IN EXCESS OF THEIR THEN CASH SURRENDER VALUE OF $74,600

Even if we assume that Section 202 (a) (1), and not Section 213 (b) (2), of the Revenue Act of 1918, *supra*, is controlling in determining the net taxable income realized by respondent on the surrender of his policies May 19, 1919, it would still be true that the Circuit Court of Appeals erred in determining their fair market price or value on March 1, 1913, for such value was not in excess of their then cash surrender value, $74,600. (R. 74, 76.)

The aggregate sum provisionally ascertained and held by the company awaiting apportionment on May 19, 1919, was on March 1, 1913, $13,600. (R. 76.) If respondent had surrendered his policies to the company on March 1, 1913, he would have received their then cash surrender value of $74,600, and he would have received all that the contracts provided that he should receive. (R. 78.)

It is clear that there were no dividends or earnings of the company which have been credited to respondent in such a way that he could have realized them on the surrender of his policies on March 1, 1913.

New York Life Insurance Co. v. *Edwards*, 271 U. S. 109.

Respondent's contracts provided that the company would on May 19, 1919, provided the insured was then living, apportion to said contracts a share in the earnings and surplus of the company, but not otherwise. On March 1, 1913, respondent's interest in the aggregate amounts provisionally ascertained and held awaiting apportionment was wholly contingent, and on his death prior to May 19, 1919, the surplus and earnings of the company would have been payable, not to him or to his beneficiaries, but to the surviving members of his class.

Not only was the share of respondent in the company's earnings and surplus wholly contingent on March 1, 1913, so far as he himself was concerned, but his "share of the forfeiture" in the redundancy of the premiums of other policy-holders of his class who did not survive or who did not persist in premium payments to the end of the tontine period was likewise not determinable on that date. *Penn Mutual Life Insurance Co.* v. *Lederer*, 252 U. S. 523, 532.

Certainly Congress in enacting the Revenue Act of 1918 could not have contemplated that the March 1, 1913, basis of establishing gain or loss and the computation of taxes imposed by that Act could in any wise be made dependent upon purely speculative and contingent future events.

As was said by the Board of Tax Appeals in the *Appeal of E. A. Armstrong*, 1 B. T. A. 296, 298:

> The Revenue Act of 1918 does not contemplate the computation of gain or loss by reference to contingent values. • • • The capital value so recoverable must be a market value, a realizable value—not a theoretical value computed by reference to some future contingent event.
>
> • • • • •
>
> The capital value at March 1, 1913, which the taxpayer is entitled to have returned before he can be said to have had taxable profit will be the cash surrender value of the policy at that date plus any accumulated dividends or excess premiums which had been credited to him in such a way that he could have realized them had he surrendered the policy on March 1, 1913. Any greater value would be purely speculative and contingent, and can not be made the basis for computing taxes.

IV

THE DEPARTMENTAL CONSTRUCTION OF THE STATUTE

Section 213 (b) (2) of the Revenue Act of 1918, *supra*, was a reenactment by Congress of the provisions of Section 4 of the Revenue Act of 1916, c. 463, 39 Stat. 756, 758. This section was again reenacted without change as Section 213 (b) (2) of the Revenue Act of 1921, c. 136, 42 Stat. 227, 238, and again as Section 213 (b) (2) of the Revenue Act of 1924, c. 234, 43 Stat. 253, 268.

The language of Section 213 (b) (2) of the Revenue Act of 1926, c. 27, 44 Stat. 9, 24, is somewhat changed, but in effect reenacts the provisions of the prior Acts and excludes from gross income—

> Amounts received (other than amounts paid by reason of the death of the insured and interest payments on such amounts) under a life insurance, endowment, or annuity contract, but if such amounts (when added to amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year) then the excess shall be included in gross income. * * *

This language was carried into Sec. 22 (b) (2) of the Revenue Act of 1928, Act of May 29, 1928.

Article 5 of Regulations 33 (Revised), promulgated January 2, 1918, is identical in substance with Article 72 (b) of Regulations 45 (1920 Edition), and the latter was carried forward into Article 72 (b) of Regulations 62, pertaining to the Revenue Act of 1921, and again into Article 72 of Regulations 65, pertaining to the Revenue Act of 1924. These regulations and the practice thereunder have now been in force for more than ten years.

Subsequent to the promulgation by the Treasury Department of Regulations 33 (Revised), January 2, 1918, under the Revenue Act of September 8, 1916, Congress passed the Revenue Act of 1918, the Revenue Act of 1921, the Revenue Act of 1924, the Revenue Act of 1926, and the Revenue Act of 1928. None of these Acts, however, questioned the con-

struction and action of the Commissioner of Internal Revenue relative to the imposition of taxes on the surrender by the policyholder of life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract. The rule applies that when Congress reenacts a statute without change it is deemed to have adopted the practice of the Department in its interpretation and application of the statute. *National Lead Co.* v. *United States*, 252 U. S. 140, 145–146.

CONCLUSION

In view of the far-reaching effect of the opinion below and the manifest importance of an authoritative rule for the guidance of the Treasury Department in the administration of the tax statutes, it is respectfully submitted that the petition for a writ of certiorari should be granted.

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SEPTEMBER, 1928.

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